

A REPORT  
TO THE  
**ARIZONA LEGISLATURE**

Accounting Services Division

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Compliance Review

# **Clifton Unified School District No. 3**

Year Ended June 30, 2005

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**Debra K. Davenport**  
Auditor General

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DEBRA K. DAVENPORT, CPA  
AUDITOR GENERAL

**STATE OF ARIZONA**  
**OFFICE OF THE**  
**AUDITOR GENERAL**

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

July 3, 2007

Governing Board  
Clifton Unified School District No. 3  
P.O. Box 1567  
Clifton, AZ 85533-1567

Members of the Board:

We have reviewed the District's audit reports for the years ended June 30, 2004 and 2005, and Uniform System of Financial Records (USFR) Compliance Questionnaire for the year ended June 30, 2005, prepared by Heinfeld, Meech & Co., P.C. to determine whether the District substantially complied with the USFR.

As a result of our review, we noted significant deficiencies in internal controls that indicate the District had not complied with the USFR. District management should implement the recommendations we have described in this report within 90 days after the date of this letter. We have communicated specific details for all deficiencies to management for correction.

We also noted that the auditors qualified their opinions on the District's financial statements for the years ended June 30, 2004 and 2005, because the District did not maintain adequate records of its capital assets.

During the 90-day period, the District may request a meeting to discuss these recommendations with my Office and the Arizona Department of Education by calling Magdalene Haggerty, Accounting Services Director, or Michael Stelpstra, Accounting Services Manager.

A member of my staff will call the Business Manager in several weeks to discuss the District's action to implement these recommendations. After the 90-day period, my staff will schedule an on-site review of the District's internal controls to determine whether the District is in substantial compliance with the USFR. Our review will cover the deficiencies we have communicated to management as well as any other internal control deficiencies we are aware of at the time of our review.

Sincerely,

Debra K. Davenport  
Auditor General

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# INTRODUCTION

Clifton Unified School District No. 3 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for over \$1.8 million it received in fiscal year (FY) 2005 to provide this education.

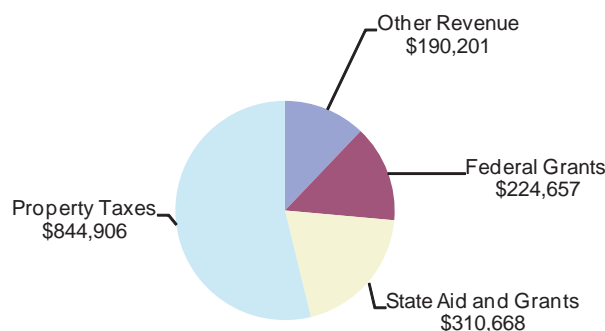
The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education (ADE). The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our review of the District's audit reports and USFR Compliance Questionnaire for the year ended June 30, 2005, we determined that the District had failed to comply with the USFR. In addition, because of inadequate capital asset records, the District's auditors qualified their opinions on the District's financial statements for the years ended June 30, 2004 and 2005. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship and to comply with the USFR. Our recommendations are described on the following pages.

## District Facts Fiscal Year 2005

County: Greenlee  
Number of Schools: 2

Number of Students: 182  
Grade Levels: K-12



Source: *Annual Report of the Arizona Superintendent of Public Instruction for Fiscal Year 2004-2005 and Clifton Unified School District No. 3 Report on Audit of Financial Statements and Report on Internal Control and on Compliance for the Year Ended June 30, 2005.*

## The District must prepare and retain student attendance records

The State of Arizona provides funding to school districts based on membership and absences. In turn, accurate attendance records are essential to ensure that the District receives the appropriate amount of state aid and local property taxes. However, the District did not retain any student attendance records; therefore, the District's auditors could not verify that membership and absences reported to ADE were accurate and that the District received the proper amount of funding. Also, the District's student counts reported on its budget work sheets did not agree to student counts reported to ADE.

The District did not maintain any student attendance records.

## Recommendations

To help ensure that the District receives the correct amount of state and local funding, the District should:

- Prepare student attendance records in accordance with ADE's *Instructions for Required Reports*.
- Retain student records and supporting documentation in accordance with the *Records Retention and Disposition for Arizona School Districts* manual published by the Arizona State Library, Archives and Public Records' Records Management Division.
- Obtain student counts from ADE's Recalculated ADM State Aid Report—ADMS 46-1 for the expenditure budget work sheets.

## The District's controls over cash should be improved

The District receives cash from various sources and maintains bank accounts to deposit the related receipts. Because of the relatively high risk associated with cash transactions, the District should maintain effective internal controls to safeguard cash, ensure that it is promptly and accurately recorded and deposited, and ensure that bank accounts are used as authorized by statute. These controls require that the District document amounts received, deposit cash receipts

Few cash controls left district monies unprotected from loss, theft, or misuse.

in a timely manner, and issue checks for allowable purposes only. However, the District did not have adequate controls over its cash receipts and disbursements. Specifically, the District did not adequately separate cash-handling and recordkeeping responsibilities, since one employee received, deposited, recorded, and reconciled receipts. In addition, authorized check signers were also responsible for purchasing, check writing, and preparing vouchers.

Additionally, the District did not prepare prenumbered cash receipts for monies it received, and inappropriately deposited miscellaneous receipts in the Maintenance and Operation (M&O) Fund revolving bank account and kindergarten and preschool tuition monies in the student activities bank account. Also, the District did not use an auxiliary operations ticket log to control the issuance of event tickets, and did not retain documentation to support that deposits were made intact and in a timely manner. In addition, the District wrote checks from the M&O Fund revolving bank account to individuals for travel advances, and then subsequently cashed the checks from undeposited cash receipts in the district safe.

Further, the District did not use the M&O Fund revolving bank account as prescribed by statute. For example, the bank account had a balance in excess of \$10,000 and was used to make expenditures that should have been processed through the normal purchasing cycle. In addition, the District did not retain supporting documentation for M&O Fund revolving bank account expenditures.

Finally, the District did not prepare monthly bank reconciliations, and the auxiliary operations account balance did not agree to the District's annual financial report (AFR).

## Recommendations

To improve controls over cash, the District should:

- Separate responsibilities among employees so that one person does not receive, deposit, record, and reconcile receipts. If one employee must perform multiple functions, a district manager or supervisor should perform reviews at appropriate points in the process and document those reviews.
- Separate responsibilities among employees so that one person does not prepare vouchers and checks, sign checks, and prepare bank reconciliations. If one employee must perform multiple functions, a district manager or supervisor should review and approve the reconciliations.
- Prepare prenumbered and numerically controlled cash receipt forms for all monies received.

USFR §§VI-C, VI-F, and X-G provide examples of appropriate separation of responsibilities.



USFR pages VI-C-3 and 4 describe M&O Fund revolving bank account procedures.

Bank reconciliation procedures are outlined on USFR page VI-C-6.

- Prepare auxiliary operations ticket logs to record beginning and ending ticket numbers, date, school, and total number of tickets issued.
- Prohibit cashing checks from receipts awaiting deposit.
- Deposit all cash receipts into the applicable bank account or directly with the County Treasurer at least weekly, or daily when significant, and retain documentation to support deposits.
- Ensure only monies raised by student efforts in connection with activities of student organizations, clubs, school plays, or other student entertainment are deposited into the District's student activities bank account.
- Operate the M&O Fund revolving bank account on an imprest basis and use the account only for activities that require immediate cash outlay, such as postage, freight, travel, and other minor disbursements. As required by statute, the imprest amount of the account may not exceed \$10,000.
- Retain documentation, such as vendor invoices and check requests, to support all expenditures.
- Prepare complete and accurate monthly written bank reconciliations for all bank accounts to reconcile bank and checkbook balances. Bank reconciliations should be prepared by an employee not responsible for handing cash or issuing checks.
- Assign a second employee to verify that the amounts reported in the AFR are accurate and are supported by the District's accounting records before submitting it to ADE.

## The District should strengthen controls over student activities monies

Poor cash controls left student monies susceptible to loss, theft, or misuse.

The District holds student activities monies raised through students' efforts for safekeeping. Therefore, the District has a fiduciary responsibility to ensure that the monies are not misused, lost, or stolen. The Governing Board is responsible for establishing oversight of these monies to ensure that proper procedures are followed for collecting and spending them. However, proper oversight was not established. For example, the District did not always prepare and retain cash collection reports, including supporting documentation, for student activities cash receipts, or deposit monies in a timely manner and retain documentation to support the deposits.

Further, the District did not retain vendor invoices and documentation to support student approval of disbursements. Also, the Governing Board did not appoint a student activities treasurer or assistant treasurer, and checks were not signed by two authorized signers. Finally, the District did not prepare monthly bank reconciliations and did not investigate reconciling items outstanding for more than 6 months.

## Recommendations

To strengthen controls over student activities monies, the District should:

- Prepare cash collection or activity reports for student activities events to document and reconcile cash collections and tickets or items sold. If it is not practical to sell tickets or count items before and after the sale, such as for bake sales, clubs should prepare cash collection reports to document cash collected.
- Deposit student activities cash receipts intact at least weekly, or daily when significant, and retain supporting documentation.
- Make disbursements from the student activities bank account only after the student club has approved them. The club should document the approval in its meeting minutes.
- Retain documentation, such as check requests or purchase requisitions, purchase orders, receiving reports, and vendor invoices to support all student activities disbursements.
- Appoint a student activities treasurer and, if applicable, assistant student activities treasurer for each school.
- Ensure that student activities checks are signed by the student activities treasurer or assistant student activities treasurer and one other person authorized by the Governing Board.
- Prepare complete and accurate monthly written bank reconciliations for the student activities bank account to reconcile bank and checkbook balances. After the reconciliations have been prepared, investigate and resolve all differences, and make appropriate corrections. Also, ensure that the checkbook balance used to reconcile the student activities bank statements agrees to the student activities check register and accounting records. Bank reconciliations should be prepared by an employee not responsible for handling cash or issuing checks.

A sample form to record cash collections and reconcile sales to cash collected can be found on USFR page X-H-21.

USFR pages X-H-9 through 11 describe disbursement processing procedures.

- Prepare a list of outstanding checks as a part of the monthly bank account reconciliation process. Investigate checks outstanding for more than 6 months, delete them from the list, and adjust the check register accordingly.

## The District must improve controls over competitive purchasing and expenditures

School District Procurement Rules for competitive sealed bidding and USFR guidelines for purchases below the competitive sealed bid threshold promote open and fair competition among vendors. This helps ensure that districts receive the best possible value for the public monies they spend. However, the District did not always follow the procurement rules and the USFR guidelines. For example, the District did

The District did not always follow competitive purchasing requirements, and therefore, could not ensure it received the best value for the public monies it spent.

not exercise due diligence for purchases made through a purchasing cooperative and did not always obtain oral and written price quotations for purchases that required them. Also, the District did not have formal credit card policies and procedures approved by the Governing Board and did not

retain credit card receipts and other supporting documentation. In addition, several gas purchases on district credit cards did not appear to be for district business. Additionally, the District did not always prepare purchase orders before making purchases and inappropriately recorded an \$18,000 purchase in FY 2006 as a FY 2005 expenditure.

Further, the District did not have adequate controls over its purchasing responsibilities. Specifically, one employee ordered and received goods and services. Also, the same person performed the physical inventory of supplies and adjusted the inventory list. In addition, the District's supplies inventory list did not include all required information, and documentation was not retained to support the actual cost of supplies on the list.

## Recommendations

To strengthen controls over competitive purchasing and expenditures and to comply with School District Procurement Rules and USFR guidelines, the District should:

- Determine whether to request oral or written price quotations or issue invitations for bids or request for proposals by analyzing the known requirements for an item or a collection of items that, in the aggregate, may result in purchases above \$5,000.

School District Procurement Rules provide the requirements for invitations for bids and requests for proposals for purchases over \$33,689.

- Document due-diligence procedures performed for at least a sample of the contracts that the District wishes to use from a purchasing cooperative to ensure that cooperative contracts were bid following the School District Procurement Rules.
- Obtain written price quotations from at least three vendors for purchases estimated to cost between \$15,000 and \$33,689, and oral price quotations from at least three vendors for purchases estimated to cost between \$5,000 and \$15,000. If the District cannot obtain three price quotations, it should document the vendors contacted and their reasons for not providing quotations. Also, if a vendor is selected for reasons other than lowest quotation, the District should document in writing the reasons for such selection.
- Establish formal written credit card policies that require authorized employees to submit credit card receipts and document the specific district purpose for each expenditure. Compare billing statements to receipts and determine that purchases represent valid district expenditures.
- Prepare and approve purchase orders before ordering goods and services.
- Ensure that expenditures are recorded in the correct fiscal year by preparing an advice of encumbrance for liabilities payable as of June 30 for all levy funds and recording payments of those liabilities in the accounting records of the prior fiscal year during the 60-day encumbrance period following June 30. Goods and services received after June 30 should be recorded and paid in the next fiscal year.
- Separate purchasing and receiving responsibilities among employees so that one person is not responsible for both.
- Separate inventory responsibilities among employees so that one person is not responsible for recordkeeping and custodial functions. If one employee must be responsible for both functions, the District should implement additional supervisory review at appropriate points in the process to help ensure adequate internal control is maintained.
- Prepare a supplies inventory list that includes all required information and retain vendor invoices to support the costs of items recorded on the list.

Guidelines for oral and written price quotations can be found on USFR pages VI-G-8 and 9 and USFR Memorandum No. 213.

Purchase order procedures are outlined on USFR page VI-G-1.

## The Governing Board should approve capital assets policies and ensure that accurate capital assets and stewardship lists are maintained

The District's auditors qualified their opinion on the financial statements because the District did not maintain adequate capital asset records.

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. In order to protect its investment, the District should establish capital assets policies and procedures that are approved by the Governing Board and followed by district management. Yet, the Governing Board did not adopt formal policies with respect to capitalization thresholds and useful lives. Also, the District did not have adequate backup procedures to ensure capital assets data would not be lost in the event of a service interruption or system failure.

Also, effective stewardship requires the District to maintain accurate lists of these assets to ensure they are properly accounted for. However, the District did not accomplish this objective. For example, numerous items on the capital assets and stewardship lists could not be located on the District's premises, and assets on the District's premises were not always on the stewardship list. The capital assets list included some inaccurate or incomplete information, and several repair and maintenance items were inappropriately included on the capital assets list. In addition, the District did not retain documentation to support historical costs of many assets on the lists, and individual payments for buildings or building improvements were improperly identified with separate identification numbers. Therefore, it would be difficult for the District to determine a building's cost.

Further, the District did not maintain accurate depreciation records. For example, assets were not properly categorized to the function the asset served, and depreciation was not accurately calculated. Additionally, the District did not always update its capital assets and stewardship lists annually for acquisitions or disposals, did not retain documentation to support approval of disposed assets, and did not maintain supporting documentation for the disposal of assets that were determined to have no value.

Finally, the District did not perform a physical inventory of equipment in the last 3 years, and the District's computerized reconciliation of capital acquisitions to capital expenditures did not agree to the capital asset additions list or to the general ledger. Also, the District did not reconcile the current year's capital assets list to the previous year's list.

## Recommendations

The following procedures can help the District ensure that its capital assets are adequately accounted for and controlled:

- Have the Governing Board adopt capital assets policies that include capitalization thresholds and standard useful lives for district assets. Capitalization thresholds may be less than those the USFR requires.
- Develop a contingency plan to safeguard capital assets data from accidental loss and destruction due to system software failure.
- Maintain a current capital assets list that includes all equipment items costing \$5,000 or more with useful lives of 1 year or more and all land, buildings, and related improvements with costs of \$5,000 or more.
- Maintain a stewardship list that includes equipment items costing between \$1,000 and \$5,000, or the District's capitalization threshold as adopted by the Governing Board if less than \$5,000.
- Affix a permanent tag with an identifying number to each equipment item costing \$1,000 or more, or specifically identify the asset on the lists by some other means, such as a serial number.
- Record capital asset items at actual cost, including ancillary charges such as sales tax, delivery, installation, assembly, and other incidental costs.
- Retain documentation, such as purchase orders, receiving reports, and vendor invoices, to support the costs recorded.
- Update the capital assets and stewardship lists annually for items acquired, disposed of, or moved to different locations.
- Perform a physical inventory of all equipment items and vehicles at least every 3 years. Assign an employee who has no custodial responsibilities to reconcile the physical inventory to the capital assets and stewardship lists, and add items or remove items from the lists as necessary.
- Ensure that depreciation is calculated accurately based on the District's useful lives, and recorded in the accounting records to the function served by the asset.

USFR pages VI-E-2 and 3 and USFR Memorandum No. 196 describe the information that should be recorded on the capital assets and stewardship lists.

Instructions for obtaining capital asset cost information are included on USFR pages VI-E-3 through 5.

Instructions for performing a physical inventory of capital assets are listed on USFR pages VI-E-8 and 9.

Instructions for disposing of assets are included on USFR page VI-E-6

The forms on USFR pages VI-E-13 and 14 may be used to document the reconciliation of capital assets additions to capital expenditures and the current year's capital assets list to the previous year's list.

- Prepare Request for Authorization to Dispose of Equipment forms or similar forms and have the Governing Board or an authorized employee approve each asset disposal. Retain documentation to support assets disposal.
- Reconcile items added to the capital assets list during the fiscal year to capital expenditures and the current year's capital assets list to the previous year's list. Make all necessary corrections.

## The District should ensure its accounting records are accurate

The District did not ensure the accuracy of its cash on deposit with the County Treasurer as its records were not reconciled.

All employees used the same password to access the District's accounting records.

The District's Governing Board depends on accurate information so it can fulfill its oversight responsibility. The District should also report accurate information to the public and agencies from which it receives funding. To achieve this objective, management must have strong internal controls to ensure that its accounting records, budget, and AFR are reliable. However, the District did not fully accomplish this objective. Specifically, the District did not reconcile its records of cash balances to the County Treasurer's records, incorrectly classified transactions, and improperly transferred monies from the Classroom Site Fund to the M&O Fund. Also, amounts reported on the AFR did not always agree with the District's accounting records or revised expenditure budget. Further, budgeted expenditures in the Soft Capital Allocation Fund exceeded the District's limit. Also, the District did not always submit required reports to ADE and the County School Superintendent (CSS), and when reports were submitted, the District did not always submit them in a timely manner. Additionally, the District did not require individual user passwords to obtain access to the financial accounting system since all employees used the same password.

## Recommendations

The following procedures can help the District record and report accurate financial information:

- Adopt information technology (IT) policies and procedures for programming, operating, and modifying IT systems.
- Separate responsibilities among employees so that one person does not have complete authority over all transactions and data. Ensure that employees only

have access to system operations that are necessary to perform each employee's specific responsibilities by assigning unique user passwords.

- Adopt budgets that do not exceed statutory limits.
- Classify all transactions in accordance with the USFR Chart of Accounts.
- Transfer monies between funds only when specifically authorized by statute.
- Reconcile the District's cash balances by fund to the County Treasurer's records at least monthly. Investigate all reconciling items and make all necessary corrections.
- Assign a second employee to verify that amounts reported on the AFR agree to the District's revised budget and accounting records before it is submitted to ADE and the CSS.
- Submit required reports to ADE and the CSS in a timely manner and retain documentation to support that the records were submitted.

USFR §III provides guidance for classifying financial transactions.

Procedures to reconcile to the County Treasurer are outlined on USFR pages VI-B-8 and 9.